

## COMMISSIONERS

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ARIZONA CORPORATION COMMISSION  
OFFICE OF COMMISSIONER LEA MÁRQUEZ PETERSON

November 17, 2020

**RE: In the matter of the application of Arizona Public Service Company for a hearing to determine the fair value of the utility property of the company for ratemaking purposes, to fix a just and reasonable rate of return thereon, to approve rate schedules designed to develop such return (Docket No. E-01345A-19-0236)**

Dear Arizona Public Service Company and All Interested Parties,

I am writing to you today to ask how we can work together to achieve a rate decrease for Arizona Public Service Company and its customers.

Specifically, I would like to see average retail electric rates in Arizona at or around \$0.09/kWh, which is competitive with other regulated states, such as Washington and Oklahoma,<sup>1</sup> and deregulated states, such as Texas and Virginia,<sup>2</sup> that we compete with for attracting jobs and economic opportunities.<sup>3</sup>

The current rate case is also occurring at an interesting juncture in our state's history, as many of the sentiments we've heard over the last several years are similar to those the Commission has heard before. By looking at what the Commission has done in the past, we can see what could be possible in the future—and I believe setting the framework for a rate decrease may be appropriate at this time.

Of note is that fact that APS has had at least two rate decreases in its past, one in 1994<sup>4</sup> and one in 1996,<sup>5</sup> totaling \$86.8 million. These add color to our understanding of what's possible.

Six rate cases spanning a period of ten years from the mid-1980s to the mid-1990s demonstrate that through a combination of performance incentive mechanisms,<sup>6</sup> hard work, and effective leadership,<sup>7</sup> the two rate reductions were not only possible, but also maintained the financial health and wellbeing of the company, despite a rapidly shifting energy landscape and uncertain financial challenges. I have listed the relevant portions of the rate cases below for your convenience.

In reading the relevant portions below, please consider them in the context of the late Richard Snell, who managed to turn around Arizona Public Service Company and its parent company, Pinnacle West Capital, following a decade of mismanagement that had occurred under his predecessor, Keith Turley.<sup>8</sup>

<sup>1</sup> See [www.eia.gov](http://www.eia.gov).

<sup>2</sup> See *id.*

<sup>3</sup> See [www.siteselection.com](http://www.siteselection.com); [www.areadevelopment.com](http://www.areadevelopment.com).

<sup>4</sup> See *APS 1994 Rate Case*, Docket No. E-01345A-94-0120, *Decision No. 58644* (Jun. 1, 1994) (authorizing a reduction of \$38.3 million, or 2.7%).

<sup>5</sup> See *APS 1995 Rate Case*, Docket No. E-01345A-95-0491, *Decision No. 59601* (Apr. 24, 1996) (authorizing a decrease of \$48.5 million, or 3.26%).

<sup>6</sup> See Paul L. Joskow & Richard Schmalensee, *Incentive Regulation For Electric Utilities*, Yale Journal on Regulation Vol. 4:1, pages 39-40 & 48-49 (1986) (noting that in November 1984 the Commission initiated an incentive program targeted at the performance of APS's generating units).

<sup>7</sup> Referring to the transition from Keith Turley to Richard Snell, as well as the Commission and its staff.

<sup>8</sup> See Comments of Richard Snell, *Oral History Transcript* (2007); Michael Lacey, *Sell, Keith, Sell*, PHOENIX NEW TIMES (Nov. 29, 1989).



By focusing on customer growth<sup>9</sup> and customer service, among other things, Mr. Snell succeeded in increasing value for his shareholders by nearly 1,000% during his nine years as the chief executive,<sup>10</sup> while at the same time agreeing to two rate decreases for his customers and navigating the emergence of IRPs and electric deregulation in the first and second halves of the 1990s, respectively.<sup>11</sup>

I believe Mr. Guldner has a similar opportunity today, to repeat history in a way that could be favorable to not only his company and the state's regulatory climate, but also to his customers, should he view his role and potential legacy on the board as analogous to that of Mr. Snell.

Accordingly, in the pending rate case, I respectfully request the parties explore the following:

- Reducing costs to consumers by focusing on customer growth, improving customer retention, and attracting new businesses to APS's service territory, including rate designs and amounts that help to attract new customers and spur economic development;
- Reducing costs to consumers by exploring new and innovative rate designs, such as value-based pricing, critical peak pricing, risk-sharing, market-based pricing, and other rate options;
- Reducing costs to consumers by proactively adapting to market conditions, reallocating risk, and taking advantage of historically low interest rates or costs of capital;
- Reducing costs to consumers by aggressively pursuing cost savings with vendors and suppliers and operating as a leaner and more efficient company;
- Reducing costs to consumers by exploring the securitization of all generating assets;
- Reducing costs to consumers by eliminating or phasing-out protracted subsidies and surcharges;
- Reducing costs to consumers by reducing peak demand, increasing economic capacities, and engaging in off-system sales to the benefit of Commission-jurisdictional customers;
- Reducing costs to consumers by looking for ways to advance new technologies, provide customer relief, and assist impacted communities without increasing rates on customers; and
- Reducing costs to consumers by utilizing performance incentive and disincentive mechanisms that are fair,<sup>12</sup> granular,<sup>13</sup> and transparent.<sup>14</sup>

<sup>9</sup> See John Dougherty, [Welcome to Prescott, California West Coast Yuppies are Making Everybody's Hometown too Expensive for its Own Resident](#), PHOENIX NEW TIMES (Feb. 9, 1994) ("APS assists rural towns in business development, advertising, direct-mail campaigns, trade shows and economic-development planning. The marketing program clearly is working.").

<sup>10</sup> From an all-time low of approx. \$4.31/share on November 24, 1989, to an all-time high of approx. \$46.13/share on June 12, 1998.

<sup>11</sup> The Commission's "Affiliated Interests" rules (A.A.C. R14-2-801 *et seq*) also emerged during this time, specifically in response to APS's conduct in the late 1980s.

<sup>12</sup> See [Decision No. 55118](#) (Jul. 24, 1986), page 20 ("A realistic analysis of operating performance must look at both the 'successes' and 'failures' if it is to avoid setting unobtainable goals of absolute perfection."); [Decision No. 55228](#) (Jul. 24, 1986), page 33 ("[T]he Commission indicated that if one wishes to choose an absolute (per se) standard of utility performance, one must be prepared to give credit for performance above the standard as for below.").

<sup>13</sup> i.e., clear, concise, specific, and measurable, including, for example, able to compare with other utility data. See e.g., [APS 1985-1988 "Palo Verde II" Rate Case](#) (Phase I), Docket No. E-01345A-85-0367, [Decision No. 55931](#) (Apr. 1, 1988), page 16 ("As a very general rule, we believe that industry data, particularly data from comparable companies, can be used to gauge the reasonableness of a utility's costs.").

<sup>14</sup> See, e.g., [APS 1985-1988 "Palo Verde II" Rate Case](#) (Phase I), Docket No. E-01345A-85-0367, [Decision No. 55931](#) (Apr. 1, 1988), pages 108-109 (describing a lack of transparency and willingness to proactively provide information to the Commission on the part of APS: "[U]tilities . . . usually anticipate [the Commission's] needs and





Lastly, please describe how we can work together to achieve \$0.09/kWh or, in the alternative, how close to \$0.09/kWh we can get if \$0.09/kWh is not possible, and how long it will take us to get there.

In February 2020, I opened a docket on performance incentive mechanisms to evaluate all options that could help us bring our utility rates and customer service experiences in line with public expectations.<sup>15</sup> Clearly, the existing model wasn't working and there was a need to reevaluate the status quo.

While we have been bombarded with new issues and revelations over the last several months, which have prevented us from building on this docket further, new opportunities to explore performance incentive mechanisms have emerged now that we have completed some of our major undertakings and have started to look ahead at what the meaning of affordable rates in Arizona will be.

In addition, interest rates have been substantially lower than the historical norm over the last several years due to lower-than-normal inflation, but the benefits have not been shared with customers.

Through this proceeding, one of the definitions that I hope we can ascribe to "performance" is that our utilities strive to strike a better balance between shareholders and customers, just as the Commission must strike a balance between the financial health and wellbeing of the company and affordability.

I look forward to seeing an innovative approach to ratemaking that will help us in the economic recovery facing families and businesses in Arizona following the pandemic.

The rate cases and relevant rate case excerpts have been provided on the pages that follow.

Sincerely,

Lea Márquez Peterson  
Commissioner



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provide statements . . . showing both total company and jurisdictional data. Not APS[.] . . . Most utilities provide a schedule for each adjustment, so that the derivation of the total and jurisdictional amount of each adjustment can be readily determined and revised, if necessary. Not APS. Finally, it is not uncommon for utilities to revise some of their adjustments for more current data and . . . [w]hen they do so, . . . voluntarily provide a reconciliation schedule so that each individual change can be identified. Not APS.”)

<sup>15</sup> See [In the matter of the investigation of the Arizona Corporation Commission into the Role of Performance Incentive Mechanisms in regulated investor owned electric utility rate cases in Arizona](#), Docket No. E-00000A-20-0019, [Application Opening New Docket by Commissioner Lea Márquez Peterson](#) (Feb. 6, 2020).



[APS 1983 Rate Case](#) (1983-1984)

[Decision No. 54204](#) (Oct. 11, 1984) (Phase I)

[Decision No. 54247](#) (Nov. 28, 1984) (Phase II)

One of the Commission's primary interests in this proceeding has been the establishment of incentive mechanisms which would . . . provide additional motivation for the efficient operation of the company . . . [and] a badly needed dose of preventative medicine to a patient afflicted with the age-old malady of "cost plus" regulation.<sup>16</sup>

[APS 1985 "Palo Verde I" Rate Case](#) (1985-1986)

[Decision No. 55118](#) (Jul. 24, 1986) (Phase I)

[Decision No. 55228](#) (Jul. 24, 1986) (Phase II)

[Decision No. 55325](#) (Dec. 5, 1986) (Phase III)

Staff . . . recommended that additional incentive mechanisms be considered.<sup>17</sup>

The testimony of Staff and RUCO witnesses have convinced us that the operating incentive provisions . . . need to be both strengthened and expanded.<sup>18</sup> . . . RUCO has identified several reasons for what it termed APS's poor management.<sup>19</sup>

[T]he Commission [has] noted APS's past difficulties in the area of inventory management. Perhaps in response to that criticism (and the similar criticism of a management audit ordered by this Commission in 1981), APS has now installed a sophisticated computerized inventory management system . . . This [Decision] gives APS a meaningful incentive to prudently manage its inventory. . . .<sup>20</sup>

The incentive issue raised by Staff and Intervenors is a valid concern from several perspectives. . . . [S]afety as well as sound engineering considerations weigh against an overpowerful incentive to reduce O&M. On the other hand, ratepayers should not be expected to sign over a "blank check" to APS.<sup>21</sup>

It will give APS an incentive to avoid escalations in these costs.<sup>22</sup>

APS should be given some incentive to control O&M costs.<sup>23</sup>

<sup>16</sup> [APS 1983 Rate Case](#) (Phase II), Docket No. E-01345A-83-0155, [Decision No. 54247](#) (Nov. 28, 1984), pages 3-4.

<sup>17</sup> [APS 1985 "Palo Verde I" Rate Case](#) (Phase I), Docket No. E-01345A-85-0156, [Decision No. 55118](#) (Jul. 24, 1986), page 8.

<sup>18</sup> *Id.*, page 15.

<sup>19</sup> *Id.*, page 20.

<sup>20</sup> *Id.*, page 29.

<sup>21</sup> *Id.*, page 5.

<sup>22</sup> *Id.*, page 6.

<sup>23</sup> *Id.*, page 8.





[APS 1985 "Palo Verde II" Rate Case](#) (1985-1988)

[Decision No. 55931](#) (Apr. 1, 1988) (Phase I)

[Decision No. 56133](#) (Sep. 15, 1988)

Whatever the cause, when faced with a surplus supply good management will strive to maximize short-term sales to other utilities and maximize the contribution those sales can make to the recovery of its fixed costs.<sup>24</sup>

In 1984, this Commission . . . found that in several APS rate cases numerous questions concerning the prudence of APS's construction . . . had been raised and left unresolved.<sup>25</sup>

Perhaps, utilities' inattention to [the basic tenet of "economic excess capacity" and the premise of "least-cost" planning] is one reason regulatory commissions throughout the country are devoting substantial efforts to formalize least-cost planning processes within the regulatory framework.<sup>26</sup>

[W]e recognize the Company has an abundance of generating capacity. . . . [T]he Company has . . . unnecessarily mothballed other units so as to give the illusion that the Palo Verde Units are used and useful . . . . If the Company can [do this], the concept of used and useful means nothing. We believe the Company has removed from service generating and transmission facilities in recognition that the system wide plant is far more than required. Estimates show that the Company has 38 percent more capacity than is needed during the peak demand.<sup>27</sup>

[W]e decided that the incentive provisions needed to be strengthened and expanded to include other generating units and that revisions to the existing plan should be considered in this docket.<sup>28</sup>

[Staff], [RUCO][,] and APS filed exceptions raising, among other things, the propriety of continuing either the [Operating Incentive Plan established by this Commission in Decision No. 55118] or the Purchased Power and Fuel Adjustment Mechanism ("PPFAM") or both. The Commission believes that the exceptions as well as the recommended order itself raise serious questions about the continuing value of either the Incentive Plan or the PPFAM to APS or its customers.<sup>29</sup>

<sup>24</sup> [APS 1985-1988 "Palo Verde II" Rate Case](#) (Phase I), Docket No. E-01345A-85-0367, [Decision No. 55931](#) (Apr. 1, 1988), page 25.

<sup>25</sup> [Id.](#), page 44.

<sup>26</sup> [Id.](#), page 69.

<sup>27</sup> [Id.](#), page 70.

<sup>28</sup> [Id.](#), page 108.

<sup>29</sup> [APS 1985-1988 "Palo Verde II" Rate Case](#), Docket No. E-01345A-85-0367, [Decision No. 56133](#) (Sep. 15, 1988), page 2.



APS 1991 Settlement Agreement (1990-1991)  
Decision No. 57649 (Dec. 6, 1991)

[Staff] and [APS] propose this rate settlement plan to keep consumers' rates as low as possible . . . by directing the utility to further reduce its costs and operate more efficiently. Under this concept, the Commission directs APS to place more emphasis on a comprehensive and aggressive program that benefits consumers.<sup>30</sup>

This proposal provides a regulatory philosophy that places increased accountability on the utility of the level of the customer's bill and the quality of service provided. . . . [T]his proposal adds additional regulatory emphasis to increase APS' accountability for prices charged to customers and the reliability of electric service.<sup>31</sup>

This public accountability is appropriate for a utility such as APS that is forging new corporate philosophies and goals based on cost management and customer service, balancing the needs of both customers and shareholders.<sup>32</sup>

APS and Staff recognize that concurrent with its attempts to meet the objectives discussed above APS must maintain high levels of service. Deterioration in service levels will be viewed as unacceptable to both APS and Staff.<sup>33</sup>

This proposal will help Arizona's economic recovery by adding stability and predictability to the rate setting process, encouraging a more efficient utility and promoting innovative, cost effective conservation programs.<sup>34</sup>

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<sup>30</sup> APS 1991 Settlement Agreement, Docket No. E-01345A-90-0007, Decision No. 57649 (Dec. 6, 1991), Exhibit 1, Agreement of Settlement of Rate Case (Nov. 18, 1991), page 1.

<sup>31</sup> Id.

<sup>32</sup> Id.

<sup>33</sup> Id.

<sup>34</sup> Id., page 2.



APS 1994 Rate Decrease (1994)

Decision No. 58644 (Jun. 1, 1994)

The Agreement provides for an immediate \$32.3 million (approximately 2.2%) reduction in APS' rates, accompanied by a commitment to fund \$6 million per year in pre-approved Demand Side Management and renewables programs, for a total of \$38.3 million per year in benefits to APS' customers.<sup>35</sup>

[T]he Arizona Corporation Commission . . . sought to keep APS' customer rates as low as possible by directing the Company to further reduce its costs and operate more efficiently. . . . APS has taken a number of aggressive steps to meet the Commission's goal of expense reduction and improved service.<sup>36</sup>

One of the fundamental principles . . . was the Company's commitment to contain its costs, and thus its rates, through disciplined cost management.<sup>37</sup> . . . The 1991 Settlement also set cost levels and the regulatory and rate consequences for failing to meet those targets.<sup>38</sup>

The settlement described below represents the Staff's "report card" on APS' performance that the Commission ordered in the 1991 Settlement.<sup>39</sup>

APS has exceeded the Commission's cost reduction goals and has improved customer service.<sup>40</sup>

These accomplishments were only possible through the cooperative alignment of regulatory and corporate goals, the public commitment and accountability to such goals, and the dedicated efforts of Staff and APS. This progress toward improved utility performance should continue.<sup>41</sup>

Staff has carefully reviewed APS' current financial condition, and believes the provisions of this Agreement . . . will sharpen management's focus on the challenges of the future in a manner that is beneficial to its customers and its shareholders.<sup>42</sup>

APS will aggressively pursue the cost savings contemplated . . .<sup>43</sup>

To meet this goal, APS will have to further reduce operating costs . . .<sup>44</sup>

<sup>35</sup> APS 1994 Rate Decrease, Docket No. E-01345A-94-0120, Staff's Notice of Filing Rate Settlement Agreement with APS (Apr. 20, 1994), page 1.

<sup>36</sup> APS 1994 Rate Decrease, Docket No. E-01345A-94-0120, Decision No. 58644 (Jun. 1, 1994), Exhibit 1, Rate Settlement Agreement (May 23, 1994), page 1.

<sup>37</sup> Id.

<sup>38</sup> Id.

<sup>39</sup> Id.

<sup>40</sup> Id.

<sup>41</sup> Id., pages 1-2.

<sup>42</sup> Id., page 2.

<sup>43</sup> Id., page 3.

<sup>44</sup> Id., page 3.





Staff will meet with APS in a good faith attempt to develop new pricing and operating procedures that are responsive to . . . the Commission's relationship to regulated utilities and their customers.<sup>45</sup>

In furtherance of the Commission's goal to establish regulatory procedures which encourage superior utility performance, the Company shall have the opportunity to earn a reward in its next general rate proceeding . . .<sup>46</sup>

APS 1995 Rate Reduction Agreement (1995-1996)

Decision No. 59601 (Apr. 24, 1996)

Since [APS's last rate case] APS has continued its cost containment efforts . . . and has recorded improved performance . . . . As a result of these events . . . the rates and charges previously authorized by the Commission should be reduced . . . and additional incentives created for efficient operation.<sup>47</sup>

Pursuant to the Amended Agreement . . . APS will implement a first year rate decrease of \$48.5 million, or 3.26%. Base rates will be reduced by \$39.3 million, and the EEASE surcharge will be abolished resulting in a further decrease of \$9.2 million.<sup>48</sup>

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<sup>45</sup> Id., page 3.

<sup>46</sup> Id., pages 7-8.

<sup>47</sup> APS 1995 Rate Reduction Agreement, Docket No. E-01345A-95-0491, Decision No. 59601 (Apr. 24, 1996), page 1.

<sup>48</sup> Id., Exhibit 1, Second Restated and Amended Rate Reduction Agreement (Apr. 18, 1996), page 1.